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During the past quarter, politics continue to drive markets (with Trump's victory in the USA, and the announcement of snap elections in Germany), and the inflation path diverged in Europe vs. the UK and the USA. The result was a generalized repricing of swap and government curves which generated interesting pockets of value.
Below is DWS selection of the top themes to consider this quarter:

1. Upcoming insurance events and key dates
2. Insurance market and product trends
3. Market pulse: Q4 investment strategies & Q5 2025 trading ideas
4. ESG developments
5. Appendix: DWS market outlook

Upcoming insurance events and key dates

- **January 2025: EIOPA liquidity risk management consultation paper concludes.** Among the options under scrutiny, EIOPA is considering requiring insurers to hold a minimum level of liquid assets using a principle-based approach, while adopting an explicit cash flow-matching framework. This is a deviation from the previous more liberal approach, and will likely trigger discussions around the asset classes that enter the perimeter of liquid assets, best practices around liquidity stress tests, as well as derivative positions and collateral management;
- **11-12 February 2025: DB/DWS Insurance CIO roundtable.** The second edition of the CIO roundtable will see the participation of 36 European and Asian insurer CIOs, representing €3.5tn in assets under management. Reinsurance/P&C/life topics will be at the forefront, in a highly interactive, panel-focused setting;
- **23rd February 2025: German elections.** This event will inform market expectations around the German pension reform as well as Bunds supply (in case of a government "debt brake" revision), among other things. Repercussions around European capital markets union reforms could also be in order.

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Insurance market and product trends

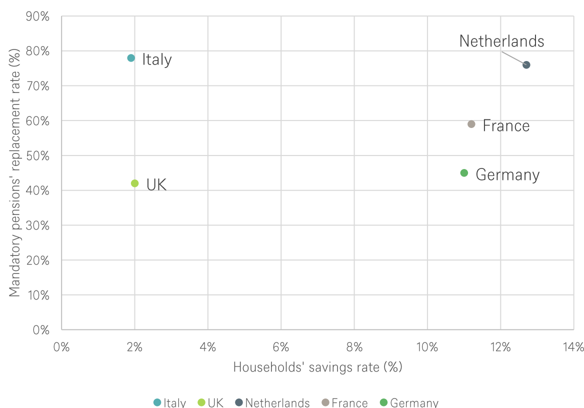
The last quarter of the year is usually a good time to ponder about long-term trends and upcoming regulatory developments. In this report, we highlight how insurers could tackle aging demographics in the old Continent by designing innovative decumulation/drawdown products. Also, we look at EIOPA's concerns around cross-border asset-intensive reinsurance by European players and explain why this may in fact be a trend to look out for.

Product design innovations and underwriting trends:

Demographics and savings product design: European life insurers are at a crossroad: on the one hand, the aging demographics (the ratio of over-65s to 14-65 year-olds is almost doubling between now and 2050) point to the need for saving products in this space. On the other hand, household savings capacity and cross-generational spending needs act as a constraint.
Lower income replacement rates (i.e. the ratio between pension and pre-retirement income) and higher savings rates potentially provide a more fertile ground for life insurers' saving products. At the same time, regional differences show how various strategies appeared successful in different countries:

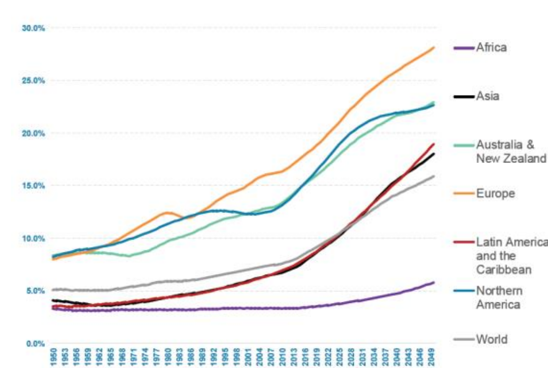
- Germany and the UK, where public pensions are less generous, developed products – such as annuities – that supplement retirement income, and that are traditionally less profitable for insurers, whereas in France and Italy there is a higher demand for savings-focused products, often capital-light, offering better capital adjusted underwriting profit margins;
- When it comes to savings rates, the UK pension risk transfer market and equity release mortgages have historically provided ways for insurers to gather assets in this space and counter relatively low savings rates. On the opposite end of the spectrum, higher savings fostered a market for whole life and variable policies in the Netherlands;
- Going forward, shrinking working-age population in Europe, and the secular move away from DB and into DC pension schemes are likely to lower income replacement ratios. Yet annuities, that in past decades have thrived in these environments, may not be an easy sell should neutral central bank rates (currently estimated to be at 2.5%) in the Eurozone continue to remain low. Innovative higher-yielding (to afford longer lifespans) and capital-light products, combining AI's more user-friendly portfolio SAA customizations with "drawdown" (or decumulation) repayment profiles could become more mainstream.

Retirement rates vs savings rates, Europe, 2023



Source: OECD (household savings – 2022, pensions at a glance – 2023), The Actuary, DWS as of January 2025 2023

Dependency Ratios across regions



Source: United Nations, Allianz Pension report, as of January 2025

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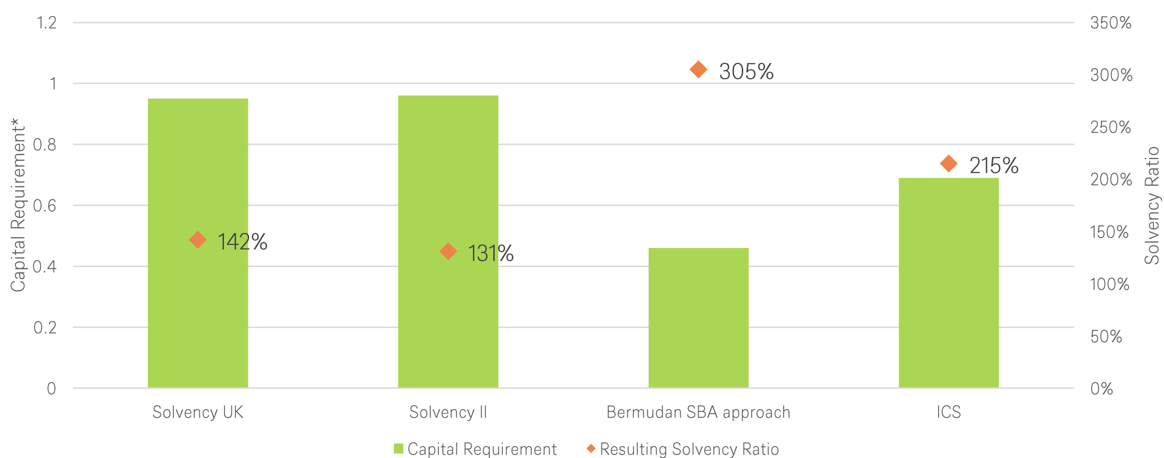
Asset Intensive Reinsurance cross-border "arbitrage": in their December 2024 Financial Risk Stability Report, EIOPA flagged "Asset Intensive Reinsurance" (AIR, i.e. the transfer of insurance liability books to a reinsurer, coupled with the outsourcing of related collateral asset management services) as a potential area of concern, albeit qualifying that the magnitude of the flows involved are currently not material from a systemic standpoint (EUR 1,370bn in GWP were ceded to reinsurers in 2023: 6% of the aggregate life premia, 25% in the case of the non-life segment). Given the material transfer of market and underwriting risks involved, EIOPA's concerns are centered around the possibility that these may be subject to lower capital requirements in some foreign jurisdictions.

While caveating that differences in regulations are not typically limited to differing capital treatments, we find this regulatory "arbitrage" to be alive and well, and think it will continue to spur reinsurance activity of European life insurers towards Bermudian and – to a lesser extent – ICS-based (e.g. Japanese) reinsurers.

A clear example of this trend is provided by the below Milliman analysis, comparing the capital treatment of a reinsurance transaction involving the transfer of a longevity risk portfolio and showing a 305% solvency ratio in Bermuda vs a 131% equivalent ratio in Europe. The analysis shows how the Solvency II market and longevity risk SCR sub-modules are a fraction of the BMA equivalents, translating in an overall capital cost to the insurer that is double what could be achieved in Bermuda.

Regulatory Capital calculations*:



*the ICS case "Spread" includes the non-default spread and credit modules
Source: Milliman illustrative analysis based on a reinsurance transaction involving a typical market share of immediate annuity business in the UK, based on CMI (Continuous Mortality Investigation) data. Please note no counterparty risk sub-module has been included in the analysis, as collateral assets are assumed to offset the need for additional counterparty-related regulatory capital

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Insurance M&A activity: “movers and shakers” in Q3 2024:

Natixis IM and Generali are engaged in early-stage talks about a potential tie up. When ratified the operation will result in the creation of a new asset management joint venture co-owned by the firms, worth EUR 1.93tn in AUM. This past summer, Natixis' owner Groupe BPCE indicated that it was open to considering partnerships and was seeking "critical size... in each area of strategic expertise, particularly by setting up new partnerships”. Generali M&A activity was most recently focused on U.S. boutique firms active in private debt space;

Amundi and AGI stop talks about combining asset management businesses. The combined entity would have managed nearly EUR 2.8tn in assets. Germany's Allianz has been examining options for its Allianz Global Investors unit, including a possible merger or partial sale of the division. The Financial Times, citing people familiar with the situation, reported that a key sticking point between the two sides had been the structure of any combination and who would have control of an enlarged group;

Nippon Life to buy Resolution Life. Nippon Life currently owns about 23% of Bermuda-based Resolution Life and aims to make it a wholly owned subsidiary in the second half of 2025, in an all-cash deal worth USD 8.2bn. Established just seven years ago, Resolution Life is a closed-book insurer that purchases existing insurance policies from insurers in the U.S. and other countries. It has $85 billion of assets under management and 4.3 million policies. Blackstone, which has been Resolution Life's investment management partner for directly originated assets including private credit and real estate, will continue the partnership after Nippon Life's takeover.

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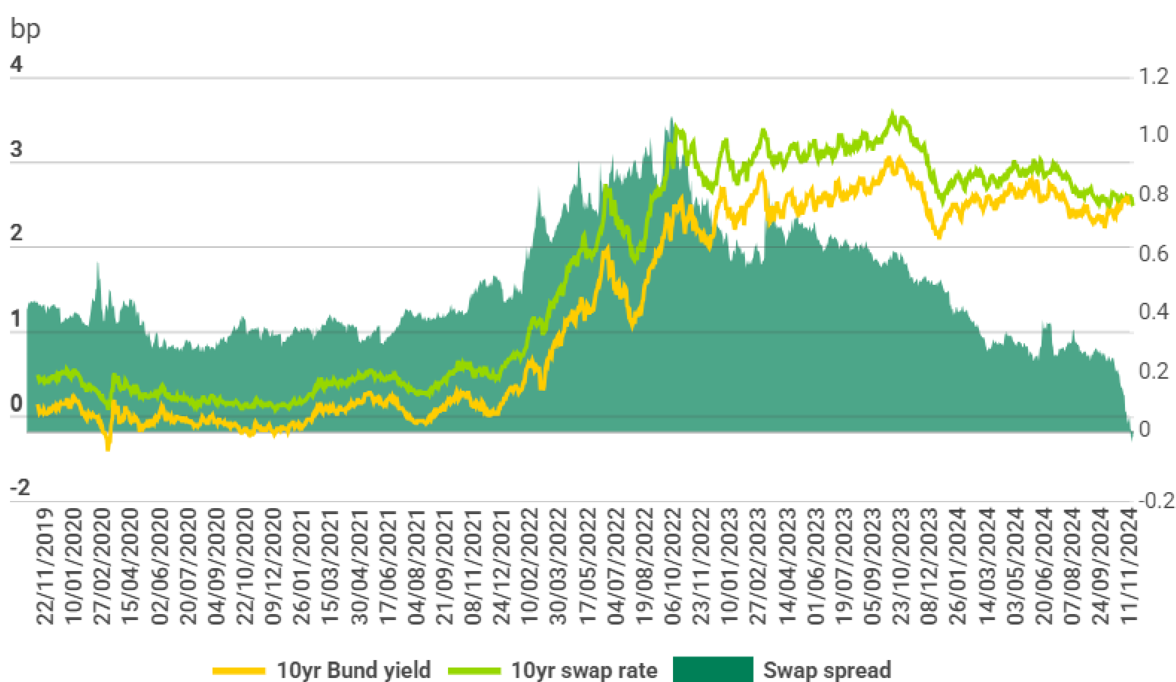
Market Pulse: investment strategies and trading ideas

Q4 was characterized by relatively tight investment grade credit spreads, with trades concentrated around the swap and government curves. Interest in higher-quality paper ("A" and above) securities across the insurance client spectrum informed the below key outline of trades we have seen in Q4 (together with the long OAT, Belgian government bonds, already mentioned in the previous IQ report, and that continued into Q4).

Q4 Investment strategies:

Euro and Sterling swap curve trades: in November 2024, the 10-year German Bund yield traded higher than the 10-year euro swap rate for the first time ever. In the U.S. and the UK, government bond yields have actually traded higher than their respective swap rates for some time, though Q4 showed record differentials across some maturities. This afforded an opportunity, especially for long-dated insurers, to hedge their >10-year liabilities (discounted at swap curve valuations) using the now-cheaper "AAA" rated Bunds or "AA" rated UK Gilts;



Source: Bloomberg, as of December 2024

Euro Government-related bond valuations: during the fourth quarter supranational and regional issuers yields have converged towards those of traditionally higher yielding government bonds (i.e. BTPs) registering a 50bps spread differential we had not seen since 2021. While valuations proved attractive, the risk dimension of the trade also proved interesting: Euro government-related securities tend to be rated "A" on average, vs BTPs "BBB" credit standing. From a capital perspective, the most attractive trades were towards those government-backed issues that qualified for a 0% Spread SCR;

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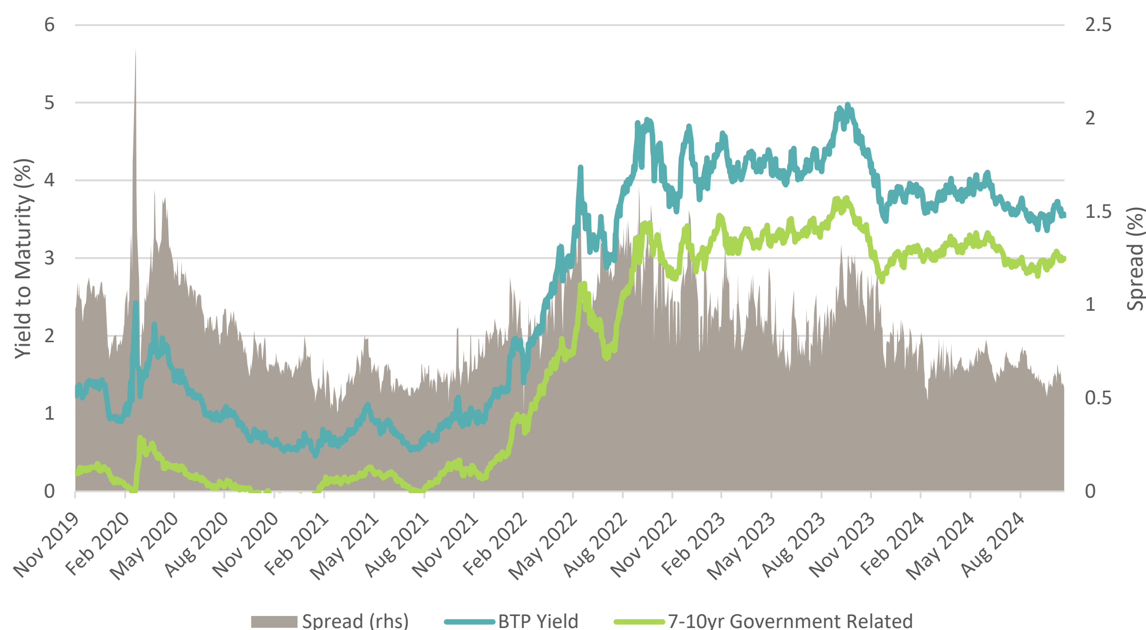
Euro Government-related bond valuations attractive vs BTPs



Source: Bloomberg, as of December 2024

Investment Grade corporates carry trade: with Eurozone credit premia at their lowest level since 2022, there was little room for further spread compression. Yet the asset class appeared to deliver on their carry potential, especially for those insurers oriented towards the "shorter" (1-7 year part) of the curve. We anticipate this trend to continue into the next year, as risk appetite appears to be on the rise (corporate earnings are expected to remain solid overall and we do not see a Eurozone recession as our base case).

Q1 2025 Trading Ideas... and key risks:

EUR-hedged global IG for insurers with long-dated liabilities. The hedging dynamics between USD and EUR are making it appear attractive for European insurers to invest in FX-hedged (via swaps) USD-denominated securities: based on our estimates, a EUR-hedged 10-year US Treasury bond can offer 30bps pick-up vs a 10-year Bund, and 35bps in the case of a 30-year security. Looking at "AA" Municipals and "A"-"BBB" Investment Grade corporates with a long-tenor (14-year duration), the achievable yields are in the 3.6% and 4% region, respectively. The above is partly driven by spread differentials, and partly by the inversion of the cross-currency swap sign: before the US elections in November, European investors buying USD securities and hedging them into EUR used to pay 25-30bps for a 15-year cross-currency swap. Now they are being paid 0-5bps (depending on ticket size, liquidity and market conditions) (all based on Bloomberg data from January 2025);

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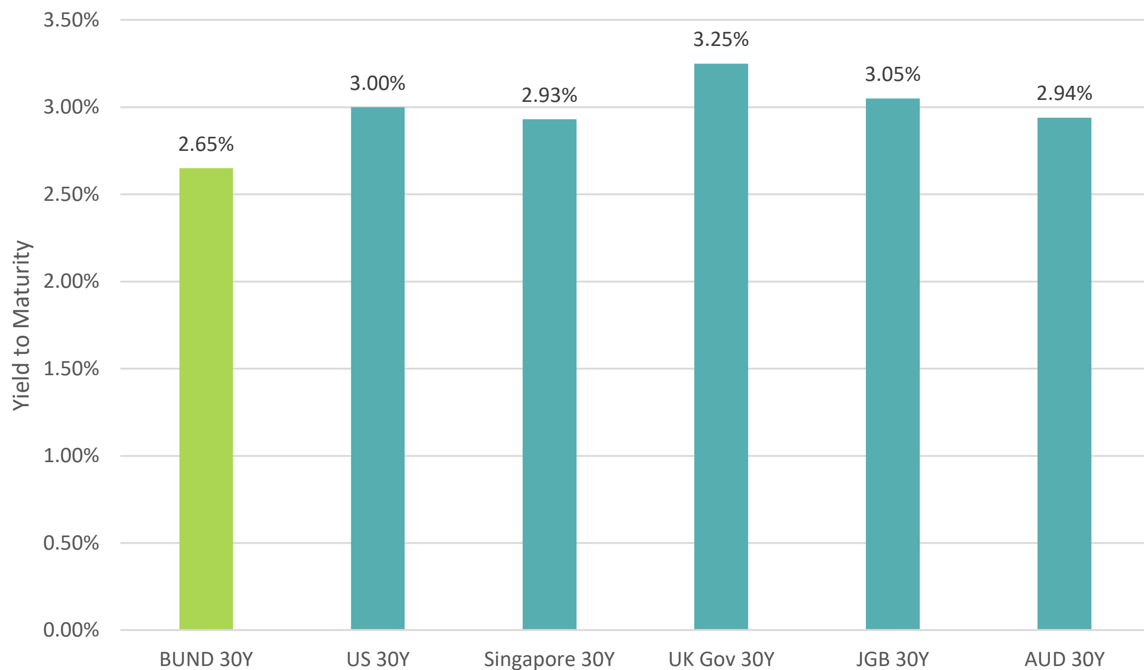
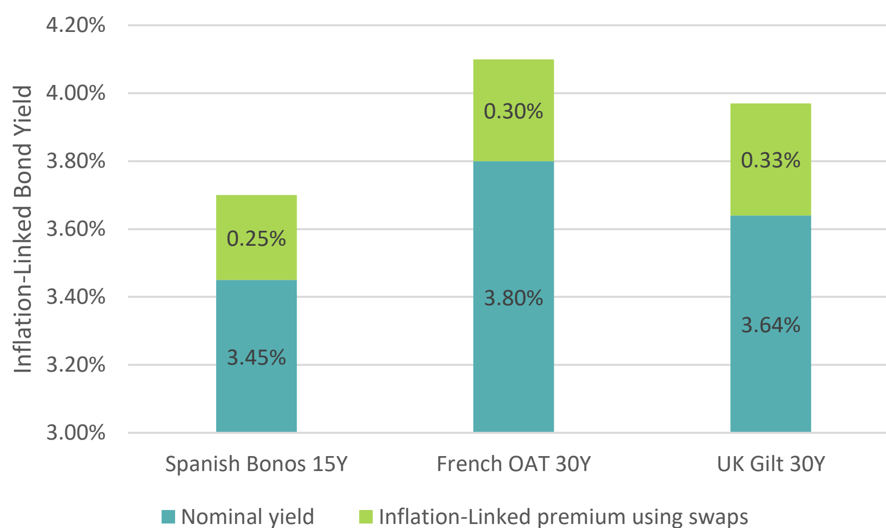


Source: Bloomberg, as of January 2025

Inflation-linked bonds premia for insurers with indexed long-end liabilities: January is typically a good month to look at inflation-linked bonds, as a lot of consumer prices get reset at the start of the year, and bond markets re-pricing is not always responsive to these changes. 2025 is no exception: we see substantial risk premia in a number of regions. Beyond the more traditional break-even nominal vs inflation-linked bonds switches, the trade we have in mind consists in buying an inflation linked bond combined with an inflation swap with a similar duration: the swap essentially translated inflation rates into a nominal yield. The result is a 25-30bps premium vs the equivalent non-inflation linked Spanish, French and UK government curves.



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Source: Bloomberg, DWS, as of January 2025

Key Risks:

- **Cross-currency swap basis reversal:** a lot of the re-pricing in cross-currency markets was related to technicals (low USD issuance by corporates domiciled in the Euro area) and market sentiment post U.S.-elections. Risk-off environments could push demand for USD higher and increase cross-currency hedging costs. Similarly, lower supply of Treasuries than expected, or renewed interest in USD-denominated issuance by foreign corporates, could reverse this course of action;
- **Inflation surprises**: negative inflation surprises vs the market consensus (i.e. lower CPI vs what is currently priced in) may negatively affect the valuations of inflation-linked bonds;
- **Geo-political shocks** are always a risk but could play both ways (stronger or weaker demand for USD). We currently see Ukraine, China and the Middle East as key areas of interest;

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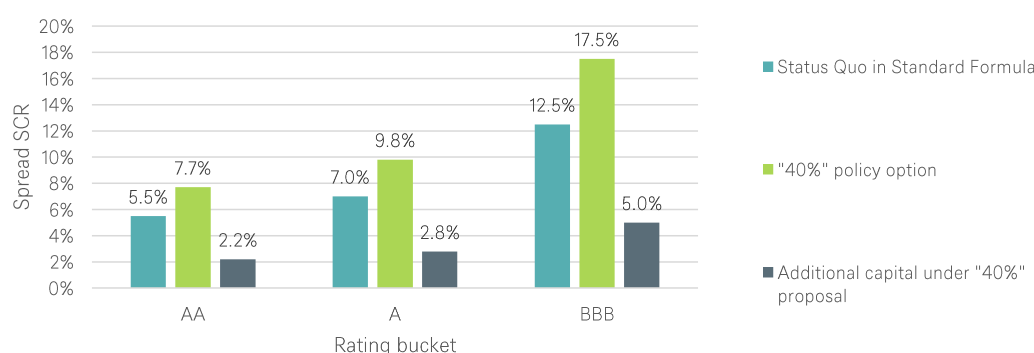
ESG Developments

- **EIOPA Fossil-Fuel SCR penalties**: After a year from the initial consultation, EIOPA concluded their analysis of climate transition risks in bond and equity portfolios, and recommended that additional SCR charges be applied to fossil-fuel related stocks. EIOPA recommends a capital charge of up to 40% for bonds (in multiplicative terms), in order to better align with insurers' actual risk exposures. While the additional capital stress may look elevated, the industries included in the "fossil fuel" categories are relatively small within the context of insurers SAA. Nevertheless, our analysis shows that bottom-up fixed income portfolio construction and issuer selection may be significantly affected, with BBB names suffering an SCR penalty of 5% at the 5-year maturity point;

EIOPA's illustrative SCR for a 5-year «fossil-fuel –related» corporate bond



Source: EIOPA, DWS elaborations, as of January 2025

If you are interested in any of the topics and would like to learn more, please reach out to me or your DWS relationship management partner.

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Appendix: DWS Market Outlook

Overview of strategic forecasts

Quarterly Update of Asset Class Forecasts

	Current level Dec 31, 2024*	Strategic Forecast Dec 2025	Expected Total Return
Capital market yields (sovereign bonds)			
United States (2-year)	4.24%	**4.20%**	4.37%
United States (10-year)	4.57%	**4.50%**	5.26%
United States (30-year)	4.78%	**4.65%**	7.02%
Municipals**	68.42	**75.00**	4.26%
Securitized / MBS**	135 bps	**120 bps**	5.11%
Germany (2-year)	2.08%	**1.75%**	2.27%
Germany (10-year)	2.37%	**2.20%**	4.34%
Germany (30-year)	2.60%	**2.50%**	4.82%
Italy (10-year)	115 bps	**150 bps**	2.76%
United Kingdom (10-year)	4.57%	**4.00%**	9.13%
Japan (2-year)	0.61%	**0.80%**	0.60%
Japan (10-year)	1.10%	**1.40%**	-0.29%
Currencies			
EUR vs USD	1.04	**1.02**	-3.54%
USD vs JPY	157	**145**	-4.10%
EUR vs JPY	163	**148**	-7.48%
EUR vs Gbps	0.83	**0.82**	-3.24%
GBP vs USD	1.25	**1.25**	0.15%
USD vs CNY	7.30	**7.45**	3.79%
Spreads (corporate & EM bonds) in bps***			
EUR IG Corp	101	**95 bps**	4.78%
EUR HY	325	**400 bps**	3.44%
US IG Corp	77	**85 bps**	5.45%
US HY	287	**325 bps**	5.36%
Asia Credit	133	**125 bps**	6.72%
EM Sovereign	325	**390 bps**	4.25%

	Current level Dec 31, 2024*	Strategic Forecast Dec 2025	Expected Total Return
Equity markets (index value in points)			
United States (S&P 500)	5,882	**6,500**	11.81%
Germany (DAX)****	19,909	**20,500**	2.97%
Eurozone (Eurostoxx 50)	4,896	**4,950**	4.60%
Europe (Stoxx600)	508	**525**	7.02%
Japan (MSCI Japan)	1,716	**1,770**	5.54%
Switzerland (SMI)	11,601	**12,050**	7.27%
United Kingdom (FTSE 100)	8,173	**8,150**	3.72%
Emerging Markets (MSCI EM)	1,075	**1,150**	9.83%
Asia ex Japan (MSCI AC Asia ex Japan)	704	**750**	9.12%
Australia (MSCI Australia)	1,635	**1,650**	4.54%
Benchmark rates in percent			
United States (federal funds rate)***	4.25-4.50	**3.75-4.00**	-
Eurozone (deposit rate)	3.00	**2.00**	-
United Kingdom (repo rate)	4.75	**3.00**	-
Japan (policy rate)	0.25	**1.00**	-
Commodities in U.S. dollars			
Gold (Spot price)	2,625	**2,800**	
Gold (Future price)	2,767		1.20%
Crude Oil (Brent Spot price)	75	**69**	
Crude Oil (Brent Future price)	72		-3.91%
Carbon	72	**75**	4.79%

	Expected Total Return
Real Estate / Infrastructure	
Listed US RE	8.50%
Non-Listed US RE	6.00%
Listed Global RE	8.00%
Non-Listed Global RE	6.60%
Listed Infrastructure	8.50%
Non-Listed Infrastructure	11.00%

*current value is based on last trading data // ** Municipals: High yield OAS; Securitized/ MBS: FNMA 30y - 7y U.S. Treasuries; ***Federal funds rate // ****DAX is a Total Return Index, no dividend yield added // ***** yield spreads are quoted in terms of one yield versus that of U.S. Treasuries, except EUR IG and EUR HY which are quoted against Bunds // Alternative investment may be speculative and involve significant risks including illiquidity, heightened potential for loss and lack of transparency. Forecasts are not a reliable indicator of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models or analysis which may prove to be incorrect. No assurance can be given that any forecast or target will be achieved. DWS expectations/forecasts as of December 31, 2024 // Source: Bloomberg Finance L.P., DWS Investment GmbH as of December 31, 2024

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